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No.

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1977

UNITED STATES OF AMERICA, ET AL., PETITIONERS

v.

LA SALLE NATIONAL BANK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

WADE H. MCCREE, JR.,
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v.

LA SALLE NATIONAL BANK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States of America and John F. Olivero, a special agent of the Internal Revenue Service, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion and order of the district court (App. A, *infra*, pp. 1a-3a) are not officially reported. The opinion of the court of appeals (App. B, *infra*, pp. 4a-20a) is reported at 554 F.2d 302.

JURISDICTION

The judgment of the court of appeals (Appp. C, *infra*, pp. 21a-22a) was entered on April 11, 1977. On July 1, 1977, Mr. Justice Stevens extended the time for filing a petition for a writ of certiorari to and including September 8, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether an internal revenue summons may properly be issued to obtain third-party records in aid of an administrative investigation conducted by the Internal Revenue Service to determine whether it should recommend to the Department of Justice that a taxpayer be prosecuted for criminal tax violations.

STATUTES INVOLVED

The pertinent provisions of Sections 7601, 7602, 7608, 7609, and 7801 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in Appendix D, *infra*, pp. 23a-25a.

STATEMENT

1. Special Agent John F. Olivero of the Intelligence Division of the Internal Revenue Service issued two summonses to respondents to compel testimony and the production of books and records in connection with his investigation of the federal income tax liabilities of John Gattuso for the years 1970-1972

(App. B, *infra*, pp. 5a-6a; Tr. 6).[1] These summonses were issued pursuant to 26 U.S.C. 7602, which authorizes the Internal Revenue Service to examine any books, papers, records, and to require testimony "[f]or the purpose of ascertaining the correctness of any return, * * * [or] determining the liability of any person for any internal revenue tax * * *" (see App. D, *infra*, pp. 23a-24a). Special Agent Olivero determined that he needed respondents' testimony and records in order to confirm the accuracy of items of rental income from real property reported on Gattuso's tax returns because the property in question was held in trust by respondent La Salle National Bank (Tr. 7). Respondent Lang, a vice-president of La Salle National Bank, appeared before Special Agent Olivero in response to the summonses but refused to testify or to produce the records (App. B, *infra*, p. 5a).

Pursuant to 26 U.S.C. 7402(b) and 7604(a), the government and Special Agent Olivero then commenced this action in the United States District Court for the Northern District of Illinois to enforce the summonses (App. B, *infra*, pp. 5a-6a). At a hearing, Special Agent Olivero testified that the purpose of his investigation was "[t]o determine tax liabilities for the years under investigation" (Tr. 6) (see also Tr. 37). Olivero further stated the focus of his inquiry was "[t]o investigate the possibility of criminal violations of the Internal Revenue Code"

[1] "Tr." refers to the trial transcript. For the convenience of the Court, we are lodging a copy of the transcript with the Clerk.

(*ibid.*). Finally, Olivero testified that neither he nor the Internal Revenue Service had made a recommendation that Gattuso be prosecuted for criminal tax violations (Tr. 11-12; App. B, *infra*, p. 6a).

At the conclusion of the hearing, the district court stated that it had "heard nothing in Agent Olivero's testimony to suggest that the thought of a civil investigation ever crossed his mind" (Tr. 61; App. B, *infra*, p. 7a). The court then indicated that it would inspect Olivero's files *in camera* to determine whether there were any civil aspects of the investigation (App. B, *infra*, pp. 7a-8a).

After such inspection, the district court denied enforcement of the summonses (App. A, *infra*, pp. 1a-3a). The court stated that "[i]t is apparent from the evidence that Special Agent John F. Olivero in his investigative activities had focused upon the possible criminal activities of John Gattuso, and was conducting his investigation solely for the purpose of unearthing evidence of criminal conduct by Mr. Gattuso" (App. A, *infra*, p. 3a). While the court recognized that Olivero had not recommended that Gattuso be prosecuted for criminal tax violations, it concluded that the "focus and determination" (*ibid.*) of his investigation was criminal. In the district court's view, "[a]n Internal Revenue summons under such circumstances is not issued in good faith" (*ibid.*).

2. The court of appeals affirmed (App. B, *infra*, pp. 4a-20a). It held that "there is ample support in the record for the district court's finding of sole criminal purpose" (App. B, *infra*, p. 11a). While the

court of appeals acknowledged that Olivero testified that his investigation had a civil purpose, it concluded that the district court discredited that testimony (*ibid.*).

In considering whether the district court applied the proper legal test, the court of appeals recognized that this Court's decision in *Donaldson* v. *United States*, 400 U.S. 517, established the governing standard for the enforcement of an internal revenue summons. There, the Court stated (400 U.S. at 536): "We hold that under § 7602 an internal revenue summons may be issued in aid of an investigation if it is issued in good faith and prior to a recommendation for criminal prosecution."

After reviewing the post-*Donaldson* decisions in the courts of appeals, the court below observed that "[t]he reported cases establish that the various circuits, including our own, have formulated several distinct standards for quashing a summons issued under 26 U.S.C. § 7602" (App. B, *infra*, p. 11a). The court further noted "that the *Donaldson* opinion has engendered some confusion" (App. B, *infra*, p. 16a). Having accepted the district court's finding that Olivero's issuance of the summonses was solely in aid of a criminal investigation, the court of appeals held that such summonses are unenforceable under the *Donaldson* standard. The court stated: "Our reading of the reported cases persuades us that the use of an administrative summons solely for criminal purposes is a quintessential example of bad faith" (App. B, *infra*, p. 19a).

REASONS FOR GRANTING THE PETITION

1. *a.* In *Donaldson* v. *United States*, 400 U.S. 517, 536, this Court held that "under § 7602 [of the Internal Revenue Code] an internal revenue summons may be issued in good faith and prior to a recommendation for criminal prosecution." The Court stated that "Congress clearly has authorized the use of the summons in investigating what may prove to be criminal conduct" (*id.* at 535). However, "where a criminal prosecution has been instituted and is pending at the time of the issuance of the summons," the Court indicated that the purpose of the summons is not a legitimate one and enforcement may be denied because "the sole objective of the investigation is to obtain evidence for use in a criminal prosecution" (*id.* at 533).

Despite the Court's unequivocal ruling in *Donaldson* that an internal revenue summons "may be issued in good faith and prior to a recommendation for criminal prosecution," the court of appeals held that a special agent may not issue a summons for third-party records in aid of a criminal investigation even though there has been no recommendation for prosecution. The distinction *Donaldson* drew, however, was not between civil and criminal investigations but between a summons issued before the Internal Revenue Service forwards its recommendation for criminal prosecution to the Department of Justice and a summons issued after such a recommendation. It is only in the latter situation that the

summons is unenforceable. Indeed, *Donaldson* itself involved basically the same situation as the present case: the issuance of summonses seeking the production of records of third persons, not of the taxpayer, by a Special Agent of the Internal Revenue Service who, like agent Olivero in this case, was conducting an investigation to determine whether criminal prosecution should be recommended.

The decision below therefore conflicts with *United States* v. *Troupe*, 438 F.2d 117 (C.A. 8), where the court stated: "The *Donaldson* case makes it clear that the summons can be successfully challenged only when a criminal prosecution has been instituted and is pending at the time of the issuance of the summons or when criminal prosecution has been recommended. Thus, it is only when the *sole* purpose of the summons is for a criminal investigation that a challenge to the summons can be made" (438 F.2d at 119; emphasis in original).

b. Moreover, the courts of appeals are in disagreement over when *Donaldson* prohibits use of an Internal Revenue summons in connection with a possible criminal case. As the court of appeals here acknowledged, "The reported cases establish that the various circuits, including our own, have formulated several distinct standards for quashing a summons issued under 26 U.S.C. § 7602" (App. B, *infra*, p. 11a). Thus, for example, in *United States* v. *Weingarden*, 473 F.2d 454 (C.A. 6), the court rejected the government's claim that a summons was enforceable even though it was issued prior to a recommendation for

prosecution. Like the decision below, the Sixth Circuit there held that "The standard is whether the sole purpose of the issuance of the summons is for criminal prosecution" (473 F.2d at 460; footnote omitted), although it acknowledged (*id.* at 460 n.11) that the Eighth Circuit's decision in *Troupe* was to the contrary.

Subsequently, in *United States* v. *Wall Corp.*, 475 F.2d 893 (C.A. D.C.), the court carried the "sole criminal purpose" test one step further beyond the *Donaldson* standard. Premising the enforceability of a summons upon the subjective motivation of the agent, the court held that "if it can be shown that the investigating agent had already formed a firm purpose to recommend criminal prosecution even though he had not as yet made a formal recommendation, issuance of the summons would presumably be in bad faith" (475 F.2d at 895). Accord: *United States* v. *McCarthy*, 514 F.2d 368, 374-375 (C.A. 3);[2] *United States* v. *Lafko*, 520 F.2d 622, 624-625 (C.A. 3); *United States* v. *Friedman*, 532 F.2d 928, 932-933 (C.A. 3); *United States* v. *Zack*, 521 F.2d 1366, 1368 (C.A. 9).

However, in *United States* v. *Hodge and Zweig*, 548 F.2d 1347, 1351, the Ninth Circuit apparently retreated from the "firm purpose" test. There, it

[2] While approving the "firm purpose" test of *Wall Corp.*, the Third Circuit in *McCarthy* declined to follow the Sixth Circuit's holding in *Weingarden* that *Donaldson* can be read to support the "solely for criminal purposes" test and not the "recommendation for prosecution" test. See 514 F.2d at 374 n. 7. See also App. B, *infra*, p. 13a n. 3.

upheld the enforcement of a summons despite the fact that both the special agent and the District Director recommended prosecution of the taxpayer under investigation. However, when their recommendations were forwarded to the Regional Counsel of the Internal Revenue Service, he requested a continuance of the investigation. The summons was issued thereafter, but before the Service formally recommended prosecution to the Department of Justice. In ordering the summons enforced, the court stated: "In our view, the formal recommendation from the Internal Revenue Service to the Justice Department is the operative recommendation under *Donaldson*" (548 F.2d at 1351; footnote omitted). Accord: *United States* v. *Billingsley*, 469 F.2d 1208, 1210 (C.A. 10).

In short, much of the confusion in the lower courts that the Court sought to eliminate in *Donaldson* concerning the proper standard governing the enforcement of an internal revenue summons (see 400 U.S. at 532-533) has reappeared once again in the post-*Donaldson* decisions. As the court below declared, "[a] review of the cases from other circuits establishes to our satisfaction that the *Donaldson* opinion has engendered some confusion" (App. B, *infra*, p. 16a).[3] This Court should resolve the disarray among

[3] The courts of appeals have also differed as to the proper weight to be given to the Court's statement in *Donaldson*—"We hold that under § 7602 an internal revenue summons may be issued in aid of an investigation if it is issued in good faith and prior to a recomendation for criminal prosecution" (400 U.S. at 536). Thus, in *United States* v. *Weingarden, supra*, 473 F.2d at 460, the Sixth Circuit characterized this language

the circuits and restore a uniform national rule with respect to this major question affecting the conduct of federal tax investigations.

2. The fundamental error of the court of appeals was its assumption that a special agent's investigatory activities are "solely for criminal purposes" so that his issuance of a summons to obtain evidence of criminal tax violations is "a quintessential example of bad faith" (App. B, *infra*, p. 19a).

The functions of the Internal Revenue Service cannot be so compartmentalized between civil and criminal purposes. The Internal Revenue Service is organized to discharge the broad responsibilities of the Secretary of the Treasury to administer and enforce the internal revenue laws (26 U.S.C. 7801(a), App. D, *infra*, p. 25a). As the Court recognized in *Donaldson* v. *United States*, *supra*, 400 U.S. at 534, each district office of the Internal Revenue Service has an audit division and an intelligence division to carry out the district director's responsibility for determining and assessing tax liability and investigating criminal and civil violations of the tax laws. While the

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as "only dictum" because the precise issue was whether the taxpayer could intervene in the summons enforcement proceeding and the Court held against intervention. But while the Third Circuit in *United States* v. *McCarthy*, *supra*, 514 F.2d at 374, agreed that the Court's statement was technically dictum insofar as the Court was not required to reach the issue, it noted "that a holding of the Supreme Court, even in dictum, should not lightly be dismissed" (*id.* at 374 n. 7). The court below concluded that the pertinent language of *Donaldson* was "an intentional formulation of an alternative holding" (App. B, *infra*, p. 17a n. 4).

Audit Division's program emphasizes the civil aspects of enforcement, it includes "participation with special agents [of the Intelligence Division] in the conduct of fraud investigations." Internal Revenue Service Organization and Functions, § 1113.563, 39 Fed. Reg. 11572, 11581. The Intelligence Division (§ 1118.6) "enforces the criminal statutes applicable to income * * * [and other] tax laws * * * by developing information concerning alleged criminal violations thereof * * *." 39 Fed. Reg. 11607.

Finally, the Assistant Regional Commissioner in charge of the Intelligence Division provides further coordination between the Intelligence and Audit Divisions by developing (§ 1114.8) "regional programs, standards and other measures necessary to implement most effectively the intelligence program of the Service *which includes the investigation of alleged tax fraud, certain other civil and alleged criminal violations of tax laws * * *, and such other special investigations as the Commissioner may direct*" (39 Fed. Reg. 11601; emphasis supplied).

These joint responsibilities of the Internal Revenue Service confirm the correctness of the Court's observation in *Donaldson* that the combined efforts of the audit and intelligence divisions "are directed to both civil and criminal infractions; and that any decision to recommend prosecution comes only after the investigation is complete or is sufficiently far along to support appropriate conclusions" (400 U.S. at 535). It was therefore unrealistic for the court of appeals to characterize the special agent's investigation in

this case as "solely for criminal purposes" (App. B, *infra*, p. 19a).

Apart from the fact that the agent testified that the purpose of his inquiry was "[t]o determine the tax liabilities for the years under investigation" (Tr. 6) and that he needed the summoned materials to determine the accuracy of reported items of rental income (Tr. 7), "[t]here is no statutory suggestion for any meaningful line of distinction, for civil as compared with criminal purposes, at the point of a special agent's appearance." *Donaldson* v. *United States*, *supra*, 400 U.S. at 535. See also *Couch* v. *United States*, 409 U.S. 322, 326. If evidence warranting a criminal prosecution is uncovered, the same evidence is also likely to result in a deficiency assessment and a civil fraud penalty (see p. 13, n. 4, *infra*).

To perform the investigative functions, Section 7602 authorizes the Secretary or his delegate "[t]o summon * * * any person having possession of * * * books of account containing entries relating to the business of the person liable for tax" or "[t]o take such testimony of the person * * *" "[f]or the purpose of ascertaining the correctness of any return * * *." The statute broadly encompasses every type of investigation, whether its direction is civil or criminal. "There is nothing in the language of § 7602 to limit the issuance of summonses to civil investigations" (*Donaldson* v. *United States*, *supra*, 400 U.S. at 537 (Douglas, *J.*, concurring)).

To be sure, the focus of a special agent's work is

on possible criminal violations, so that he is only assigned to a case "as a result of some allegation or indication of criminal conduct" (*Donaldson* v. *United States*, *supra*, 400 U.S. at 537 n. 1 (Douglas, *J.*, concurring)). See also *Beckwith* v. *United States*, 425 U.S. 341, 345. But until the Internal Revenue Service refers a case to the Department of Justice with a recommendation for prosecution, "the civil aspects [of the investigation] are inextricably associated with the criminal" (*United States* v. *Billingsley*, *supra*, 469 F.2d at 1210). Thus, the presence of a special agent does not necessarily mean that prosecution will ensue.[4]

3. Although the court of appeals acknowledged that the final paragraph of this Court's *Donaldson* opinion established the recommendation for prosecution by the Internal Revenue Service as the line of demarcation between a civil and a criminal case, it nevertheless concluded that a summons issued prior to such a recommendation would not meet the "good faith" requirement of *Donaldson* if it were "solely for criminal purposes" (see App. B, *infra*, p. 19a). The court relied upon the earlier discussion in *Donald-*

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[4] In 1976, the Intelligence Division commenced 8,797 full-scale tax fraud investigations. Only 2,037, or approximately one-quarter, of these resulted in recomendations for prosecution. The 6,760 cases not recommended to the Department of Justice involved approximately $11 million in deficiencies and penalties. See 1976 Annual Report of the Commissioner of Internal Revenue, pp. 33, 61, 152. The 1969 statistics considered by the Court in *Donaldson* are comparable (see 400 U.S. at 535 n. 17).

son with respect to the dictum in *Reisman* v. *Caplin*, 375 U.S. 440, 449, that—

> the witness may challenge the summons on any appropriate ground. This would include, as the circuits have held, the defenses that the material is sought * * * for use in a criminal prosecution, *Boren* v. *Tucker*, 239 F.2d 767, 772-773, * * *.

In explaining this dictum, the Court in *Donaldson* stated that "The *Reisman* dictum * * * comes into proper focus as applicable to the situation of a pending criminal charge or, at most, of an investigation solely for criminal purposes" (400 U.S. at 533). Emphasizing the final phrase of this sentence, the court of appeals held that a summons issued "solely for criminal purposes" would not meet the "good faith" standard of *Donaldson*.

But, as we have shown, *Donaldson* holds that there is no meaningful line that can be drawn between the "civil" and "criminal" purposes of a special agent's investigation prior to the Internal Revenue Service's recommendation for prosecution (400 U.S. at 535). Hence, we submit that if a summons is issued for one of the purposes enumerated in Section 7602 relating to the functions of the Internal Revenue Service and not for ulterior purposes or harassment, it will meet the "good faith" standard of *Donaldson*. See *United States* v. *Powell*, 379 U.S. 48, 57-58.

Moreover, the Court's discussion in *Donaldson* (400 U.S. at 533) of its *Reisman* dictum demonstrates that the phrase employed in *Donaldson*—"an investigation solely for criminal purposes" (*ibid.*)—referred to the

agent's inquiry after the Service's recommendation for prosecution.

After noting that a summons is improper if it is issued after a criminal prosecution has been instituted, the Court stated (400 U.S. at 533) that it was "precisely * * * [that] situation—where the sole object of the investigation is to gather data for criminal prosecution—that is the subject of the *Reisman* dictum." As the Court further observed, "This is evident from the fact that the dictum itself embraces the citation of *Boren* v. *Tucker*, 239 F.2d 767, 772-773 (CA 9 1956), an opinion in which, at the pages cited, the Ninth Circuit very carefully distinguished *United States* v. *O'Connor*, 118 F. Supp. 248 (Mass. 1953), a case where the taxpayer already was under indictment" (400 U.S. at 533).

Since the Court had earlier cited with approval those cases that expressly sanctioned the use of a summons issued to investigate criminal conduct when no criminal prosecution had been instituted (see 400 U.S. at 532-533 n. 14), the phrase "an investigation solely for criminal purposes" refers to a case where the Internal Revenue Service has already recommended prosecution. The court of appeals' conclusion that the pre-recommendation investigation of a special agent is "solely for criminal purposes" under *Donaldson* is therefore erroneous.

4. The court of appeals' ruling that an agent's subjective motive can be taken into account in determining whether a summons is issued in "good faith" threatens to impair the enforcement of the

internal revenue laws. In any investigation conducted by a special agent of the Internal Revenue Service, the focus of the inquiry is to ascertain whether there is any evidence of criminal conduct, but that inquiry also necessarily involves questions of civil tax liability. If the courts continue to depart from the line of demarcation established in *Donaldson* and engage in a search for the agent's "sole purpose" or "firm purpose," the enforceability of summonses will continue to be subject to litigation-producing uncertainties, and summons enforcement proceedings will become enmired in a host of factual details and subjective inquiries that are irrelevant to the purposes of the summons power set forth in Section 7602. The potential for delay of criminal investigations beyond the expiration of the statute of limitations would require the Internal Revenue Service "in a situation of suspected but undetermined fraud, to forgo either the use of the summons or the potentiality of an ultimate recommendation for prosecution," and thereby "stultify enforcement of federal law" (*Donaldson* v. *United States*, *supra*, 400 U.S. at 536).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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SEPTEMBER 1977.

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 75 C 3842

THE UNITED STATES OF AMERICA AND JOHN F. OLIVERO, Special Agent, Internal Revenue Service, PETITIONERS

v.

LA SALLE NATIONAL BANK, JOSEPH W. LANG, Vice President of La Salle National Bank, RESPONDENTS

MEMORANDUM OPINION AND ORDER

The United States of America and John F. Olivero, Special Agent, Internal Revenue Service, as petitioners, have asked the Court to judicially enforce two Internal Revenue summonses served upon the respondent, La Salle National Bank.

At a hearing on the petition, the evidence established that, at the time of the issuance of the summonses, Special Agent John F. Olivero was assigned to the investigation of possible tax liabilities of one John Gattuso, that his investigation had not been completed, and that he had made neither a preliminary investigative report nor a recommendation for criminal prosecution. Agent Olivero testified that he had not yet determined whether to recommend criminal prosecution in the case.

Respondents contend that Special Agent Olivero was in fact conducting an investigation of criminal

violations of the Internal Revenue Code by John Gattuso and that, under these circumstances, utilization of an Internal Revenue summons to obtain evidence was an abuse of this summons. The evidence further revealed that Special Agent Olivero was the only agent assigned to this investigation and that no revenue agent was working in conjunction with him.

The Court recognizes that civil and criminal investigations may go forward side by side before a determination of the ultimate focus of the investigation is made. The Court recognizes further that the presence of a special agent assigned to the investigation does not automatically make it a criminal investigation.

It is an improper use of an Internal Revenue summons to serve it solely for the purpose of obtaining evidence for use in a criminal prosecution. *Reisman* v. *Caplin*, 375 U.S. 440 (1964). On the other hand, it is not an improper use of an Internal Revenue summons to issue it in aid of an investigation, if the issuance is prior to a recommendation for criminal prosecution and in good faith. *Donaldson* v. *United States*, 400 U.S. 517 (1971).

The recommendation for criminal prosecution is certainly the event which definitely determines the focus of the Internal Revenue Service upon criminal prosecution as the end and goal of its investigation. It is apparent, however, that this focus and determination may be arrived at, under certain circumstances, before the actual recommendation for criminal prosecution has been made. In the event such focus and determination has been arrived at at the time of the issuance of the Internal Revenue summons, the fact that it precedes the formal recommendation for criminal prosecution is not relevant. An Internal Revenue summons under such circumstances is not issued in good faith.

The Supreme Court in the *Donaldson* case, *supra*, leaves no doubt that it regards as inappropriate the issuance of an Internal Revenue summons in an ". . . investigation solely for criminal purposes." *Donaldson* v. *United States*, 400 U.S. 517, at 533.

It is apparent from the evidence that Special Agent John F. Olivero in his investigative activities had focused upon the possible criminal activities of John Gattuso, and was conducting his investigation solely for the purpose of unearthing evidence of criminal conduct by Mr. Gattuso.

Therefore the petition of The United States of America and John F. Olivero, Special Agent of the Internal Revenue Service, for the enforcement of Internal Revenue summonses served upon the respondent, La Salle National Bank, is denied.

ENTER:

/s/ Frank J. McGarr
FRANK J. MCGARR
United States District Judge

DATED: March 9, 1976

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 76-1572

UNITED STATES OF AMERICA and JOHN F. OLIVERO,
Special Agent of the Internal Revenue Service,
PETITIONERS-APPELLANTS

v.

LASALLE NATIONAL BANK and JOSEPH W. LANG,
Vice-President of the LaSalle National Bank,
RESPONDENTS-APPELLEES

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

No. 75-C-3842—FRANK J. MCGARR, *Judge*

ARGUED JANUARY 6, 1977—DECIDED APRIL 11, 1977

Before PELL and SPRECHER, *Circuit Judges*, and EAST, *Senior District Judge.**

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* Senior District Judge William G. East of the United States District Court for the District of Oregon is sitting by designation.

PELL, *Circuit Judge*. This is an appeal from an order of the district court entered on March 9, 1976, denying enforcement of two IRS summonses served upon the LaSalle National Bank and its vice-president, Joseph W. Lang. The issue presented is whether the district court erred in finding that the two summonses were issued in aid of an investigation solely for criminal purposes and were unenforceable for that reason.

I.

Special Agent John F. Olivero was conducting an investigation of the federal tax liabilities of John Gattuso. On August 15, 1975, petitioner Olivero issued the instant summonses, directing the respondent LaSalle National Bank to appear before him on September 2, 1975, to testify and to produce for examination certain books, records, and papers. Respondent Lang appeared in response to the summonses but failed to testify or produce the records demanded.

On November 11, 1975, the United States and Special Agent Olivero petitioned the district court for enforcement of the summonses pursuant to 26 U.S.C. §§ 7402(b), 7604(a).[1] The petition prayed, *inter alia*,

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[1] 26 U.S.C. § 7402(b) provides:

If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurdisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

[Footnote continued on page 6a]

for an order directing the respondents to show cause why they should not comply with and obey the aforementioned summonses in each and every requirement thereof. The district court issued the order to show cause pursuant to which a hearing was held on December 5, 1975.

At the hearing, Special Agent Olivero reiterated under repeated questioning that he was attempting to determine whether or not there were any criminal violations of the Internal Revenue Code. He also testified that the purpose of his investigation was "to determine the tax liabilities for the years under investigation." In response to a direct question from the court, Olivero stated that he had not made a determination in his own mind as to whether to recommend criminal prosecution. The agent could not recall specifically reading Section 539 of the Handbook for Special Agents of the Intelligence Division, but admitted in response to another question from the court that he had not kept a chronological work sheet in connection with his investigation of the tax liability of John Gattuso. He could not recall whether he had seen any or all of the documents demanded from the respondent by the summonses.

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[3] [Continued]

26 U.S.C. § 7604(a) provides:

> If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which said person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

The respondents called Olivero and Gregory J. Perry as witnesses. Respondents had served a subpoena upon Olivero seeking all files concerning or relating to Gattuso but excused the agent after the district court judge indicated that respondents had not yet sustained the burden of raising a substantial question concerning the validity of the summonses. The judge indicated that he would examine the records in camera if the respondents' presentation of their case suggested that the records should be inspected. Thereupon, the respondents called Perry, who testified that he had asked Olivero at a meeting of June 11, 1975, what civil aspect of the investigation Olivero was getting into. When Olivero said "his investigation was strictly related to criminal violations" of the Internal Revenue Code but would not disclose them, the meeting quickly came to a close. Perry testified that he asked Olivero whether there was any Revenue Agent or officer assigned to the case with him and that Olivero said "no, strictly a criminal investigation."

After hearing testimony, the court stated that it had heard nothing in Agent Olivero's testimony to suggest that the thought of a civil investigation ever crossed his mind. The judge indicated that he would undertake the in camera inspection of the materials in the file in view of his understanding that if there was a possibility that information regarding civil tax liability might come up, it was a civil investigation until Olivero closed it. The judge also observed that unless he found something in the in camera inspec-

tion that gave more support to the Government's position than did Olivero's testimony, it would be the court's conclusion that Olivero was at all times involved in a criminal investigation, at least in Olivero's mind.

After considering the in camera material, the testimony, and various memoranda submitted by the parties, the district court denied enforcement of the summonses. In its Memorandum Opinion and Order, the district court recognized that it was not an improper use of an IRS summons to issue it in aid of an investigation if the issuance was prior to a recommendation for criminal prosecution and in good faith, citing *Donaldson* v. *United States*, 400 U.S. 517 (1971). The court further recognized that civil and criminal investigations might go forward side by side before a determination of the ultimate focus of the investigation was made. Again, the court recognized that the presence of a Special Agent assigned to the investigation did not automatically make it a criminal investigation. After noting that the Supreme Court in *Donaldson*, *supra*, had left no doubt that it regarded as inappropriate the issuance of an IRS summons solely for criminal purposes, the court stated:

> It is apparent from the evidence that Special Agent John F. Olivero in his investigative activities had focused upon the possible criminal activities of John Gattuso, and was conducting his investigation solely for the purpose of unearthing evidence of criminal conduct by Mr. Gattuso.

Believing that the district court had either clearly erred in this finding of fact or had acted out of a mistaken view of the law, the United States filed a notice of appeal on May 7, 1976.

II.

The first question in this case concerns our scope of review. Although the district court judge's statement that Olivero was conducting his investigation solely for the purpose of unearthing evidence of criminal conduct was not formally labelled as either a finding of fact or a conclusion of law, we think that it must be regarded as a finding of fact. The district court judge reviewed the testimony of the two witnesses, and his performance of this function must be considered that of a fact finder.

In *United States* v. *National State Bank*, 454 F.2d 1249, 1252 (7th Cir. 1972), we recognized that the rule of *Donaldson* v. *United States*, 400 U.S. 517, 536 (1971), validated IRS summonses when issued "in good faith and prior to a recommendation for criminal prosecution." There, the district court had granted enforcement. In affirming that judgment, we characterized the essence of the district court's decision as factual findings that the summons there challenged had been "issued in an investigation of civil liability with a possibility of criminal prosecution but with no criminal prosecution pending, and was accordingly issued in good faith." *Id.* We determined that "[t]he record justified the [district] court's finding of those

facts." *Id.* Thus, this court has ruled that a finding as to good faith is a factual finding the review of which is controlled by the clearly erroneous standard of Rule 52(a), Fed.R.Civ.P.

Technically, *National State Bank, supra,* does not speak to the question of whether a converse determination is exactly analogous. In their main brief, the petitioners contend that a finding of sole criminal purpose is either a mixed finding of fact and conclusion of law or a finding of ultimate fact which involves the application of legal principles. The petitioners cite *United States* v. *Weingarden,* 473 F.2d 454, 460 (6th Cir. 1973), as authority for the proposition that, in either case, it is reviewable as a matter of law. In their reply brief, the petitioners shift position. Apparently guided in part by the respondents' vigorous argument that no other reported case holds that a finding such as that made in the instant case is not a finding of fact, the petitioners concede that *United States* v. *Cleveland Trust Company,* 474 F.2d 1234, 1236 (6th Cir. 1973), *cert. denied sub nom. Miceli* v. *United States,* 414 U.S. 866; and *United States* v. *Zack,* 521 F.2d 1366, 1369 (9th Cir. 1975), point to an opposite conclusion from that of *Weingarden.* The petitioners now argue that resolution of the question is a false issue in the case, inasmuch as it was quite clear that an improper legal test was applied in making a finding of sole criminal purpose.

We are not persuaded that an improper legal test was applied, and thus we cannot so simply evade the question. We hold that the clearly erroneous standard governs review of findings that an IRS summons has or has not issued in good faith. Assuming arguendo that the Supreme Court has not overruled or qualified *Donaldson* in its more recent adjudications, there is ample support in the record for the district court's finding of sole criminal purpose. The record establishes that Olivero testified to the existence of a civil purpose but that the district court, who observed the demeanor of the witnesses, discredited that testimony. We are not left with a firm and definite conviction that mistake has been made.

III.

The second question in this appeal is whether the district court applied the proper legal test in making its finding of fact. The reported cases establish that the various circuits, including our own, have formulated several distinct standards for quashing a summons issued under 26 U.S.C. § 7602.

The major problem in determining the proper legal test arises from the language of the *Donaldson* opinion. In the thirty-fourth paragraph of the decision, 400 U.S. at 533, the Supreme Court stated that the dictum of *Reisman* v. *Caplin,* 375 U.S. 440 (1964),[2]

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[2] The *Donaldson* opinion, 400 U.S. at 532, identified the following passage from *Reisman, supra* at 449, as dictum, referring to it thereafter as "the *Reisman* dictum":

> [T]he witness may challenge the summons on any appropriate ground. This would include, as the circuits have held, the defenses that the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution, *Boren* v. *Tucker,* 239 F.2d 767, 772-773, as well as that it is protected by the attorney-client privilege.

comes into proper focus as applicable "to the situation of a pending criminal charge or, at most, of an investigation solely for criminal purposes." However, the *Donaldson* opinion used different language in the thirty-eighth and last paragraph, 400 U.S. at 536, where it stated:

> We hold that under § 7602 an internall revenue summons may be issued in aid of an investigation if it is issued in good faith and prior to a recommendation for criminal prosecution.

Subsequent to *Donaldson*, the courts of appeals have devoted considerable intellectual energy to the analysis of its language. Usually, the Gowernment has argued that the single standard for determining the validity of an IRS summons is the "recommendation for prosecution" standard. Although some cases have appeared to accept that position, *e.g.*, *National State Bank*, *supra* at 1252, the more recent decisions have highlighted the role of *Donaldson's* "good faith" language.

In *Weingarden*, *supra*, the Sixth Circuit noted that the formulation of the standard which authoring Justice Blackmun prefaced with the words "We hold" was technically dictum. 473 F.2d at 460. *Accord*, *United States* v. *McCarthy*, 514 F.2d 368, 374 n.7 (3d Cir. 1975); *United States* v. *Lafko*, 520 F.2d 622, 625 n.5 (3d Cir. 1975). *See also United States* v. *Friedman*, 532 F.2d 928, 932 (3d Cir. 1976). Thus, the *Weingarden* court relied instead on the *Donaldson* paragraph relating to the *Reisman* dictum, ruling that "[t]he standard is whether the sole purpose

of the issuance of the summons is for criminal prosecution." 473 F.2d at 460.

In *United States* v. *Wall Corporation*, 475 F.2d 893, 895 (D.C. Cir. 1972), the court, after setting forth the *Donaldson* paragraph dealing with the Supreme Court's "holding," stated that inquiry was not ended upon a determination that prosecution had neither been instigated nor recommended. The rationale for probing beyond mere "recommendation for prosecution" was that *Donaldson* also required that a summons be issued in "good faith." The *Wall* court stated that if it could be shown that the investigating agent had already formed a firm purpose to recommend criminal prosecution, even though he had not as yet made a formal recommendation, issuance of the summons would presumably be in bad faith. 475 F.2d at 895.

In *McCarthy*, *supra* at 373-75, the Third Circuit reviewed the precedents applicable to the "criminal purpose defense" recognized in *Reisman*, *supra*, and the "good faith" defense discussed in *Wall*, *supra*.[3] As to the first, it observed that the defendants had not alleged that a recommendation for criminal prosecution had been made prior to the issuance of the

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[3] *McCarthy* declined to follow *Weingarden*, *supra*, which it read as holding that *Donaldson* could be read as promoting the "solely for criminal purposes" test and not the "recommendation for prosecution" test. At the same time, however, *McCarthy* stated that the portion of the *Donaldson* opinion found in the last paragraph of Justice Blackmun's opinion for the court was, technically speaking, mere dictum. *See* 514 F.2d at 374 n.7.

summons. Accordingly, it ruled that the defendants' allegations were insufficient to bring the matter on unenforceability on the grounds of criminal purpose into controversy. 514 F.2d at 374. As to the latter, it determined that the defendants' allegations sufficiently raised the possibility that the IRS agents had no intention of pursuing any civil remedies as to bring into question their good faith. *Id.* at 375. Accordingly, it held that the district court should conduct a hearing concerning the issues raised by the allegations of the absence of civil purpose.

More recently, the Third Circuit has apparently retreated from an effort to approach *Donaldson* through an analysis distinguishing its holding from its supposed dictum. In *Friedman*, *supra*, 532 F.2d at 932, the court stated that the standards for judicial enforcement of a § 7602 summons were found in *Donaldson*, and explained in *McCarthy*, *supra*, and even more recently, in *Lafko*, *supra*. The *Friedman* opinion explains that these cases recognize that the IRS has no authority to conduct a criminal investigation through the use of a § 7602 civil summons, noting that no court has given a thorough or persuasive justification for this construction. 532 F.2d at 932 n.9. The *Friedman* case recognizes that *Donaldson* and the Third Circuit cases hold that the mere fact that criminal as well as civil liability may result will not prevent judicial enforcement if (1) the Intelligence Division has not yet recommended prosecution, (2) the agent has not already formed a firm purpose to recommend prosecution, (3) the summons is not

being used to harass the taxpayer, and (4) the material referred to in the summons has not already been inspected by the Government. *Id.* at 932.

The *Friedman* formulation of a four-prong basis for denying enforcement of an IRS summons represents a careful articulation of the principles gleaned from the many cases considering the validity of particular summonses. As an *a priori* approach, its analysis has much to recommend it. However, we can hardly fail to note that the *Friedman* analysis sedulously avoids any use of the phrase "in good faith," substituting instead a reformulation which sets forth the circumstances under which denial of enforcement is proper. Instead of attempting exegesis of the language of *Donaldson*, the *Friedman* case traces the contours of precedent back to the original formulation of a rationale by Judge Wyzanski in *United States* v. *O'Connor*, 118 F.Supp. 248 (D. Mass. 1953).

The Ninth Circuit has taken a different approach. In *United States* v. *Zack*, *supra*, 521 F.2d 1366, the court reviewed a district court order denying enforcement of an IRS summons. The lower court had conducted a hearing and made a finding of fact that the investigation's sole purpose was to establish criminal liability. Upon the Government's appeal, the court followed *Weingarden's* ruling, 473 F.2d at 460, that an IRS summons, if issued solely for criminal purposes is not issued in good faith, even though there has been no recommendation for prosecution. Thus, *Zack* determined that indictment or recommendation of criminal prosecution was not a prerequisite to a

finding that an investigation is solely criminal. 521 F.2d at 1368.

Significantly, *Zack* again found it necessary to reconcile the various pasages in the *Donaldson* opinion. After directing attention to that portion of the opinion discussing the *Reisman* dictum, *see* 400 U.S. at 533, *Zack* turned to the last, "holding" paragraph. It concluded that even prior to a recommendation for criminal prosecution, an administrative summons should not be enforced unless it is issued in good faith. The court explained, *supra* at 1368:

> We harmonize this "good faith" requirement with the language disapproving the use of the summons in "an investigation solely for criminal purposes" by concluding that the government would not be in good faith if it uses an administrative summons solely for criminal prosecution purposes. Thus, in this case, if the administrative summons was used solely for criminal purposes, it is not issued in good faith and is impermissible. This is true even though there has been no recommendation for prosecution.

In carrying out its hermeneutical task, the *Zack* court took no position on the characterization of the concluding *Donaldson* paragraph as holding or dictum.

A review of the cases from other circuits establishes to our satisfaction that the *Donaldson* opinion has engendered some confusion. Accordingly, we shall take at face value the words of the authoring Justice and characterize the final paragraph of the opinion for the court as constituting a holding of *Donald-*

son.[4] Thus, it is proper for a district court to grant enforcement of an IRS summons if it is issued in good faith and prior to a recommendation for criminal prosecution. Conversely, if a summons is issued in bad faith or after a recommendation for prosecution, enforcement must be denied.[5]

We agree with the respondents that the petitioners' arguments ignore the good faith requirement of *Donaldson*. We further agree that the real issue before the court is whether the Internal Revenue Service may issue a summons solely in aid of a criminal investigation and still meet the standard of good faith as enunciated in *Donaldson*. Because we are persuaded that *Zack's* reconciliation of the various

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[4] The courts have characterized the final paragraph as mere dictum because the Supreme Court did not have to rule on the sufficiency of the taxpayer's claims, one of which was the criminal purposes defense. *See, e.g., McCarthy, supra.* 514 F.2d at 374 n.7. However, the Supreme Court was perfectly aware that its holding that the taxpayer's interest was not of sufficient magnitude to support intervention effectively disposed of the case. In *Donaldson, supra* at 531, the authoring Justice states, prior to Part VII's resolution of Donaldson's arguments, that "[t]his conclusion [*i.e.*, insufficient interest to support intervention] could dispose of the case, for our *main concern* here is with the taxpayer's asserted right to intervention in the particular enforcement proceedings." (Emphasis supplied.) That the Court went on to examine its *Reisman* dictum appears to us an intentional formulation of an alternative holding.

[5] Although our prior cases of *United States* v. *Turner*, 480 F.2d 272 (7th Cir. 1973); and *United States* v. *Awerkamp*, 497 F.2d 832 (7th Cir. 1974), use different phraseology, they are consistent with this interpretation of *Donaldson*.

Donaldson paragraphs accurately delineates what the Supreme Court has held, we must reject the petitioners' arguments.

The Government insists that there was no evidence that Special Agent Olivero was not simultaneously pursuing a civil investigation. Reading the record evidence in this fashion, the petitioners submit that it is clear that the special agent's investigation encompassed the purpose of determining the taxpayer's tax liability. Suggesting that the district court misfocused its inquiry, the petitioners insist that the only relevant inquiry is whether the investigation in aid of which the summons is issued is directed at least in part toward determining the liability of some person for an internal revenue tax.[6] The Government argues that once it is demonstrated that there is nothing unusual or sinister about the special agent focusing his attention on the criminal aspects of the case, the finding of sole criminal purpose must fall.

We think that the Government oversimplifies the evidentiary posture of the case. Special Agent Olivero testified that he was pursuing a civil aspect, but the record establishes that the district court did not believe him.

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[6] In their main brief, the petitioners state that "[i]t is the government's position that a summons may be used solely for the purpose of criminal investigation at any time prior to the final recommendation for criminal prosecution." They found it unnecessary to advance the argument because of their view that the evidence in this case clearly established that the special agent's investigation encompassed a civil aspect.

We note that the district court expressly observed that the bona fides of the investigation was in issue. The Government attempts to use the district court's statement as an indication that it applied the wrong legal test. Our reading of the reported cases persuades us that the use of an administrative summons solely for criminal purposes is a quintessential example of bad faith. In view of our reading of the crucial language in *Donaldson*, *see* 400 U.S. at 536, we read the statement as a faithful reflection of that decision's alternative holding.

We have examined subsequent Supreme Court decisions, such as *Couch* v. *United States*, 409 U.S. 322 (1973); *Beckwith* v. *United States*, 425 U.S. 341 (1976); and *Fisher* v. *United States*, 425 U.S. 391 (1976). Although those cases establish that a taxpayer is clearly the "focus" of a criminal investigation when the matter is assigned to the Intelligence Division of the Internal Revenue Service, they do not reflect in our reading of them any intent of the Supreme Court to qualify or cut back its holding in *Donaldson*, *supra* at 536. Accordingly, the "bad faith" test spelled out by that decision is controlling law.

We note that the district court formulated its factual finding by use of the expression "sole criminal purpose" rather than by a label such as "bad faith." We find no basis for reversible error in that verbal formulation. The district court grasped the vital core of *Donaldson* and rendered its factual find-

ing consistently therewith. Accordingly, its order denying enforcement of the two IRS summonses is AFFIRMED.

A true Copy:
Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX C

Opinion by Judge Pell

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

No. 76-1572

April 11, 1977

Before

Hon. WILBUR F. PELL, JR., Circuit Judge
Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. WILLIAM G. EAST, Senior District Judge *

UNITED STATES OF AMERICA AND JOHN F. OLIVERO, Special Agent of the Internal Revenue Service,
PETITIONERS-APPELLANTS

v.

LA SALLE NATIONAL BANK AND JOSEPH W. LANG, Vice-President of the LaSalle National Bank,
RESPONDENTS-APPELLEES

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

No. 75-C-3842

FRANK J. MC GARR, Judge

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* Honorable William G. East, Senior Judge, United States District Court for the District of Oregon, sitting by designation.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

APPENDIX D

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 7601. CANVASS OF DISTRICTS FOR TAXABLE PERSONS AND OBJECTS

(a) *General Rule.*—The Secretary or his delegate shall, to the extent he deems it practicable, cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all with respect to which any tax is imposed.

(b) *Penalties.*—

For penalties applicable to forcible obstruction or hinderance of Treasury officers or employees in the performance of their duties, see section 7212.

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

SEC. 7608 [as added by Sec. 204(14), Excise Tax Technical Changes Act of 1958, P.L. 85-859, 72 Stat. 1275]. AUTHORITY OF INTERNAL REVENUE ENFORCEMENT OFFICERS.

* * * *

(b) [as added by Sec. 6(a)(1), Act of October 23, 1962, P.L. 87-863, 76 Stat. 1141] *Enforcement of Laws Relating to Internal Revenue Other Than Subtitle E.*—

(1) Any criminal investigator of the Intelligence Division or of the Internal Security Division of the Internal Revenue Service whom the Secretary or his delegate charges with the duty of enforcing any of the criminal provisions of the internal revenue laws or any other criminal provisions of law relating to the internal revenue for

the enforcement of which the Secretary or his delegate is responsible is, in the performance of his duties, authorized to perform the functions described in paragraph (2).

(2) The functions authorized under this subsection to be performed by an officer referred to in paragraph (1) are—

(A) to execute and serve search warrants and arrest warrants, and serve subpoenas and summonses issued under authority of the United States;

(B) to make arrests without warrant for any offense against the United States relating to the internal revenue laws committed in his presence, or for any felony cognizable under such laws if he has reasonable grounds to believe that the person to be arrested has committed or is committing any such felony; and

(C) to make seizures of property subject to forfeiture under the internal revenue laws.

SEC. 7801. AUTHORITY OF DEPARTMENT OF THE TREASURY.

(a) *Powers and Duties of Secretary.*—Except as otherwise expressly provided by law, the administration and enforceemnt of this title shall be performed by or under the supervision of the Secretary of the Treasury.

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